MECHANICAL COTTON METHOD AND NEW TREND INDICATOR

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(1948 course)

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CAPITAL REQUIRED

The first point to consider when you start to operate with any Method on the Cotton Market is the amount of capital required, with which you can trade and never lose your capital and over a period of 5, 10, or 15 years be able to make profits, because a Method that will make profits and never lose your capital is the kind of a method that every man should follow to make a success.

As a general rule, I have always considered it advisable to use at least $1,500 capital for every 100 bales of Cotton traded in and to limit stop loss orders to not more than 30 points on every 100 bales. In this way you will be able to make 10 consecutive trades on your capital and the market would have to beat you 10 consecutive times to wipe out your capital, which it will not do. Whatever amount of capital you use to trade with, follow this rule! Divide your capital into 10 equal parts and never risk more than 10% of your capital on any one trade. Should you lose for 3 consecutive times, then reduce your trading unit and only risk 10% of your remaining capital. If you follow this rule your success is sure.

For the Mechanical Trend Indicator Method, you can start with a capital of $1,000 when Cotton is selling under 10¢ per pound and begin trading in 100 bales, provided you make your first trade at a time when you can place a stop loss order not more than 30 points away, in fact, you should try to start when your risk will only be 20 points. In other words, with a capital of $1,000 you must figure that you would be able to make at least 7 to 10 trades with your capital and that the market would have to beat you 7 to 10 consecutive times to wipe out your trading capital. With this Method it is impossible for that to happen, *provided you follow the rules and trade on definite indications.*

Use a capital of $1,000 to trade in Cotton when it is selling under 30¢ per pound. From 12¢ to 20¢, use $1,500 for each 100 bales. From 20¢ to 30¢

use $2,000 for each 100 bales. From 30¢ to 40¢, use $3,000 capital.

If you want to start trading in a smaller unit on the New Orleans Cotton Exchange, use a capital of $500 for each 50 bales in normal markets and never risk more than 30 points on the initial trade. When markets are abnormal and at prices like 1946, 1947 and 1948, brokers require margin or $1500 to $2,000 to trade in 50 bales. Under these conditions when there are wide fluctuations you can trade and risk 40 to 50 points on each trade, but try to keep your stop loss order 20 to 30 points above tops and below bottoms when possible. Then follow the same pyramiding plan as you would with a larger capital, never risking more than one-tenth of your capital on any one trade.

HOW TO KEEP THE CHART FOR THE TREND INDICATOR

Keep up daily high and low chart on each option and mark the opening and closing prices on this chart.

The Trend Indicator or Trend Line is obtained by following the daily moves. As long as an option is advancing and making higher bottoms and higher tops, the Indicator or Trend Line moves up each day to the highest price and continues to move up as long as the market makes higher tops and higher bottoms.

The first day that the option reverses and makes a lower bottom by 5 points or more, you move the Trend Line down to that bottom. Then, on the following day if the option moves down to a lower bottom, you move the Trend Line to the low of that day and continue to move it down as long as Cotton makes lower bottoms.

Then, the first day that Cotton records a higher bottom and a higher top you move the Trend Line up again to the top of that day.

This Trend Line simply follows the swings of an option.

NEW HIGH AND NEW LOW THE SAME DAY

If an option makes a higher top in thr early part of the day than the previous day, then before the market closes, goes down and makes a lower bottom than the previous day, you move the Trend Line up to the higher top reached in the early part of the day, then move it down to the bottom made later in the day.

The idea of the Trend Indicator is to show each higher top and lower bottom so that you will always know where an option starts down from the last top or starts up from the last bottom.

WITHIN DAY

By a *"within day"* I mean a day when an option makes a higher bottom but does not make a higher top than a previous day; in other words, it remains within the range of the previous day.

If an option is declining and only rallies one day, making a higher bottom but not making a higher top, then breaks to new lows, I do not consider it important or advisable to move the Trend Line up; neither would I move the stop loss order down above this *"within day"* top unless it was after a prolonged decline in a fast-moving market.

Apply this same rule when an option is advancing and makes a lower top but not a lower bottom the same day, remaining within the range of the previous day; then if it advances to a higher level the following day, the Trend Line should not be moved down and stop loss orders should not be moved up under this bottom unless there has been a prolonged advance in a fast-moving market.

"Within moves" last sometimes as much as 2 or 3 days, that is remaining 2 or 3 days on a side move without breaking the bottom of a previous active day or crossing the top of that day. When a change occurs after a move of this kind, go with it. If it breaks the bottom after a series of *"within days"* go short. If it crosses the top after s series of *"within days*, consider the trend up and go long.

HOW TO USE STOP LOSS ORDERS

With this Method you must always use a stop loss order 10, 20, 30 or 40 points below the bottoms or above the tops made by the Trend Indicator.

Remember, stops are placed above or below the top or bottom of the Trend Indicator, and NOT placed above or below the high and low for the day, except when you are applying the 7 to 10-day Rule and following a pyramiding move up or down, or where there is a Signal Top or Bottom Day, when you place stop loss orders above the top of the Signal Day or below the bottom of the Signal Day. The reason that it is called a Trend Line is because we do not record moves made during the day but only when an option makes a lower top and a lower bottom or a higher bottom and a higher top.

When Cotton is moving slowly, you can use 10-point stop loss orders with greater success and larger profits, but when it fluctuates rapidly the move will often go 15 points over a top or under a bottom and not go 20 points, therefore a 20-point stop loss order will not be caught as often. A stop loss order 30 points under a Trend Line bottom or over a Trend Line top will be caught less frequently than the 10 or 20-point stop loss orders. However, as a general rule, I only advocate using 30-point stop loss orders in very active markets.

SPACE CHARTS

You can keep charts of every 10, 20, or 30 point move up or down, but the most important in active markets is the 20-point chart. When Cotton breaks 10 points under a bottom on the 20-point chart or crosses a top on the 20-point chart by 10 points, it indicates a change in trend.

HOURLY CHARTS

In active, fast-moving markets, where you can get the prices every hour, it is important to keep the Hourly high and low and also mark the opening of the hour and the closing of the hour.

Apply the same rules that you do to your Daily high and low chart, and the first time that the market breaks a Trend Line bottom on the Hourly Chart or crosses a Trend Line top, consider that the trend has changed temporarily.

If there are several hours with tops around the same level or a series of bottoms around the same level, then when the market crosses 5 points over an Hourly top, or breaks 5 points under an Hourly bottom, consider that the trend has changed at least temporarily and trade accordingly.

Even in a narrow market or in a market that is moving 10 to 25 points per day, if you keep an Hourly high and low Chart, you will see the value of it in getting a quick change in trend.

TRADING INSTRUCTIONS

BUYING AND SELLING POINTS

RULE #1: TRADING ON TREND LINE INDICATIONS ONLY

The simplest and easiest rule to use is to buy 100 bales, 50 bales or any other unit that you start trading in, and place a stop loss order 20 points under the last Trend Line bottom; then follow up with a stop loss order 20 points under the last Trend Line bottom and never use any other indication to sell out until the Trend Line breaks 20 points under a previous Trend Line bottom, where your stop is caught. Then reverse, selling 100 bales, or whatever your unit is and following that down with a stop loss order 20 points above each Trend Line top until your stop loss order is caught. Then reverse and go long again.

Remember, always allow your Trend Indicator to be your guide. When it turns down, follow it and do not expect a change until the Trend Indicator shows it. That is what your Trend Indicator is for— to keep you with the trend of the market. When it changes, you must change and reverse your position accordingly.

This rule will make the cautious investor or trader a very large percentage of profits each year if he trandes when Cotton is active. The higher the price Cotton is selling at, the more money this rule will make.

RULE #2: BUYING AT DOUBLE OR TRIPLE BOTTOMS

Buy against double or triple bottoms and protect with stop loss order 10, 20, or 30 points away according to the price and activity. When an option makes the same price level a few days apart, it makes what we call a double bottom on the Trend Indicator. A triple bottom is when an option makes bottom around the same level of prices the third time. A second or third bottom can be slightly higher or lower than the previous bottom, but remember this rule:

When you buy at the time an option reaches the third bottom, you should never risk more than 20 points, for when the third bottom is broken, especially if this bottom is around the same level, and your stop is caught, it will indicate that the main trend has changed and you should double up and go short.

Always reverse position when the trend changes. If you are long of the market and your stop is caught, you must go short. If you are short of the market and the trend changes and your stop is caught, you must go long or buy an equal amount.

The safest buying point is whdn an option makes a triple bottom near the same level, protecting with a stop loss order not more than 20 points under the lowest level of the triple bottom.

RULE #3: SELLING AT DOUBLE OR TRIPLE TOPS

This rule is just the reverse of Rule #2. Sell against double or triplo tops with a stop loss order 10, 20, or 30 points above the top, but on a third top never use more than a 20-point stop loss order because, as a general rule, when an option reaches the same price level the fourth time, it goes thru and moves higher. Therefore, it is always a sure indication that when Cotton goes above the third top, you can buy it for higher prices.

RULE #4: FOURTH TIME AT THE SAME LEVEL

Triple bottoms are the strongest and triple tops the strongest, but it is very important to watch an option when it reaches the same level the fourth time as it nearly always goes thru. Therefore it is safe to reverse position and pyramid when an option goes thru a triple top or crosses the same price level the fourth time.

Reverse the rule on the downside: Where triple bottoms are made close together and an option goes to this level the fourth time, it nearly always goes thru. Therefore, when triple bottoms are broken, reverse position, sell out all longs and go short, always going with the trend and never against it.

RULE #5: ASCENDING OR RISING BOTTOMS AFTER A TRIPLE BOTTOM

After an option makes a third or triple bottom, then has a rally and from this rally reacts again, making a fourth bottom higher than the previous bottoms, it is a sign of strong support and indication of higher prices. Then, if the fifth bottom is higher, it is a still stronger indication that a greater advance will take place.

RULE #6: DESCENDING OR LOWER TOPS AFTER A TRIPLE TOP

After a triple top, watch the fourth top or the first rally after Cotton breaks away from the triple top. If this fourth top is lower than the previous tops, it is a sign of weakness and lower prices. Then after a decline, if the next top of a rally (which would be the fifth top counting from the first) is still lower, it is a sign of extreme weakness and indicates much lower prices.

RULE #7: 7 TO 10-DAY RULE FOR AN ACTIVE, FAST-MOVING MARKET

When Cotton is very active, declining fast and making lower tops and lower bottoms each day, after it has declined 7 days or more, you should make your stop loss orders 20 points above each day's top, and when your stops are caught, reverse position and buy, placing stop loss order 20 points under the previous day's bottom.

When Cotton is very active and advancing fast, after it has advanced 7 to 10 days or more without breaking a previous day's bottom, you should follow your purchase up with a stop loss order 20 points under each day's low until the stop is caught. Then reverse and go short, placing a stop loss order 20 points above the previous day's top.

But do not consider that the main trend has changed up or down until Cotton crosses a Trend Line top or breaks under the last Trend Line bottom.

PYRAMIDING

RULE #8: HOW TO PYRAMID

Much larger profits can be made pyramiding, and it is just as safe to pyramid if you adhere strictly to the rules.

If you are trading in 100 bales, then after you buy or sell the first 100 bales, when the market moves 40 to 50 points in your favor or when you have $200 to $250 profit, buy or sell 100 bales more so long as the Trend Indicator shows that the main trend is still up or down. Continue to buy or sell 100 bales more every time the market moves 40 to 50 points in your favor, always placing a stop loss order not more than 20 points below the Trend Line bottom or 20 points below each day's lowest, if you are long, and not more than 20 points above the Trend Line top or 20 points above each day's highest, if you are short. If you have pyramided until you have 500 bales, then you should have an order in to sell 600 bales on stop, which would put you short 100 bales to start a new deal. Pyramid again in the same way or as long as the market moves in your favor.

But remember, when Cotton has moved 300 to 350 points in your favor, you must watch for a change in trend and be careful about buying or selling another lot on which you would have to take a loss. In active high-priced markets the move may run 500 to 720 points before an important change in trend.

RULE #9: THE RUN OR PYRAMIDING MOVE

The big money in pyramiding is made in the run between accumulation and distribution. Pyramids should be started after double or triple bottoms. Then, when you get into this run, buy every 40 to 50 points up, protecting with a stop loss order 20 points under each day's bottom or 20 points under the last Trend Line bottom. By following up with a stop loss order 20 points under the Trend Line bottom, you will not get out until the main trend has changed. But in fast-moving markets, after you have bought the 5th or 6th lot, then it is safest to keep your stop loss orders 20 points under each day's bottom, because in active, fast-moving markets Cotton often declines 200 to 350 points in 2 days without breaking the Trend Line bottom or without declining and moving down on the 3-day Chart. If you use your rule for determining the top day, then you can get out before the trend changes or even before Cotton breaks the bottom of a previous day.

RULE #10: PYRAMIDING ON TREND LINE INDICATIONS ONLY

This pyramiding plan is simple and easy to use. You simply use Rule #1 to make your first trade, buying the first lot after the Trend Line Indicator shows uptrend by crossing a Trend Line top by 20 points; then use Rule #9 for buying the second lot after Cotton breaks out of a trading range, but remember, never buy the second lot until Cotton crosses the highest top of the trading range.

In a declining market, sell the first lot after the Trend Line shows downtrend by breaking a Trend Line bottom by 20 points; then use Rule #9 for selling the second lot after Cotton breaks out of a trading range, only selling the second lot when Cotton breaks the lowest bottom of the trading range.

RULE #11: SAFEST PYRAMIDING RULE

One of the safest rules to use for pyramiding when Cotton is at extremely high levels or extremely low levels is to start with 100 bales and when the market moves 50 points in your favor, buy or sell another 50 bales; then when it moves 50 points more, buy or sell 50 bales; then on the next 50-point move in your favor, buy or sell 50 bales. Continue to follow the market up or down with this amount until there is a change in trend.

RULE #12: FAST MARKETS AND WIDE FLUCTUATIONS

In fast-moving markets, like the years of 1923, 1927, 1929, and 1946, when you pyramid and have very large profits, you should follow down with a stop loss order about 50 points away from the market. Then, after a severe decline reduce stop loss orders, placing them about 40 to 50 points above the low level, because when a market is moving so fast as this, you should not wait for the Trend Indicator to show a change in trend by crossing a Trend Line top or even a previous day's top before changing position; also apply rules for determining bottom by Signal Day and Opening and Closing Prices.

Reverse this rule in an advancing market.

RULE #13: WHEN NOT TO PYRAMID

Never buy a second lot for a pyramid when Cotton is near a double top or sell a second lot when Cotton is near a double bottom.

Safety is the first consideration in starting or continuing a pyramiding campaign in Cotton. Mistakes are made by buying or selling a second lot too near the accumulation or the distribution point. After a big run up or down, you must always wait for a definite change in trend before starting to pyramid.

Cotton often holds for several days or weeks in a range of 50 to 75 points moving up and down, not crossing the highest top or breaking the last bottom made. When it does get out of this range, crossing the highest top or breaking the lowest bottom, it indicates a bigger move and you should start to pyramid, buying the second lot after it makes a new high or selling when it breaks to a new low.

HOW TO DETERMINE CHANGE IN TREND

RULE #14: MINOR TREND INDICATOR

In a declining market, never consider that the minor trend has turned up until the trend changes on the Trend Line Chart or Trend Indicator. To change the trend on the Trend Indicator, Cotton must advance 20 or more points above the last top on the Trend Indicator, according to the activity and price of Cotton, whether you are using 10, 20, or 30-point stop loss orders above the previous top

In an advancing market, never consider that the minor trend has turned down until Cotton breaks 20 or more points under the last bottom on the Trend Indicator or Trend Line Chart.

Remember that breaking 10 points under a daily bottom or going 10 points over a daily top does not change the trend.

RULE #15: MAIN TREND INDICATOR

After a prolonged advance, never consider that the main trend has changed until a bottom made by the 3-day Chart has been broken.

After a prolonged decline, never consider that the main trend has turned up until a top made by the 3-day Chart has been crossed. It is very important to keep up a 3-day Chart. (See page 11.)

RULE #16: BREAKAWAY POINTS

Watch the point and price from which the last move starts up and when that price is broken, consider that the main trend is changing to the downside.

When Cotton is in strong position at high levels, watch the last bottom or starting point of the last move to new highs. When this level is broken, it is an indication that the main trend is turning down.

Watch the point and price from which the last move starts down and when that price is crossed, consider that the main trend is changing to the upside.

When Cotton is in a weak position at low levels and slowly working lower, making lower tops and lower bottoms, it is important to watch the last top or the point where Cotton breaks away from and makes new lows. Never decide that the main trend has turned up until Cotton begins to cross some of these levels that it broke away from.

RULE #17: SECOND AND THIRD HIGHER BOTTOMS AND LOWER TOPS

Watch the second and third higher bottoms. When Cotton breaks a second higher bottom, consider the main trend has changed to the downside.

Watch the second and third lower tops. When an option crosses the third lower top, consider the trend has turned up, at least temporarily, and go with it.

RULE #18: SECTIONS OF A MOVE

It is important to study the different sections or moves that Cotton makes between the first low level and the first, second, third, fourth, or fifth tops of a move. After Cotton has had several moves up and reacted, when it is near the end of the move, the gains over the last previous top will be less and the run from the last bottom to the last top will be less than in the early stages of the movement, an indication that the move has run out and that a culmination is near. Then apply your other rules and watch the Trend Indicator and 3-day Chart for a reversal in trend.

In a declining market, apply the same rule. When the declines or sections of a move become shorter, it indicates that the selling pressure is waning.

Watch the first rally ,or first reaction after top or bottom has been made, and if Cotton runs 50 or 60 points, then watch the action of the next move of 50 to 60 points up or down. Cotton will often rally ,or react about this same number of points three or four times but watch for a change the fourth time.

Cotton will often react or rally 90 to 100 points several times in a big campaign. Watch the first time the reverse move is greater than 100 points as this will often mean a change in the main trend.

RULE #19: 30-FULL POINT INDICATION AT BOTTOM OR TOP

In very weak markets watch for the first advance of 30 full-points from any low level and in very strong markets for the first reaction of 30 full-points, which will indicate a change in the minor trend. By 30 full-points I mean, for example, from 630 low, a rally to 660 would be 30 full-points. If the low was 628, we would not count 30 full-points until the option rallied to 660.

Reverse this rule when Cotton is advancing. Suppose it advances to 668 and has not had a 30 full-point reaction for some time. Then if it declines to 630, I would consider it a 30 full-point reaction and an indication that the minor trend is reversing. In that case, if Cotton only declined to 638, or even to 631, we would not count it a full 30-point reaction, because full points are based on even figures.

RULE #20: SHARP 2-DAY SIGNAL MOVE

After a prolonged decline Cotton often has a sharp 2-day rally, making a very wide range in price, then moves in this same range for several days or weeks without getting higher than the top of the 2-day rally or without breaking the previous bottom. This shows support or accumulation. Then when the top of the 2-day rally is crossed, it is an indication that you should buy a second lot to start a pyramid.

Apply the same rule after a sharp 2-day decline, which does not change the main trend because Cotton does not decline into the 3rd day, but later when the bottom of this sharp 2-day decline is broken, it is an indication that the main trend has turned down and you can start to pyramid again.

IMPORTANCE OF OPENING AND CLOSING PRICES

RULE #21: SIGNAL TOP DAY

The opening and closing prices are very important when Cotton is very active and reaches extreme high or low.

On the day that extreme high price of a move is reached after a big advance, if Cotton closes near the low of the day or closes below the halfway point of the day's range or closes below the opening, it indicates that the selling is better than the buying and that Cotton is getting ready to turn the trend down, at least temporarily. When there is a move of this kind, you should sell out and go short without waiting, placing a stop loss order on the shorts 20 points above the final day's high.

RULE #22: SIGNAL BOTTOM DAY

On the day that Cotton has a sharp break after a prolonged decline, if it closes higher than the opening or above halfway point or better still if it closes at the extreme high, after making a wide range and going lower than the previous day, it is an indication that the buying is better than the selling and that the trend is getting ready to turn up or that a bigger rally may be expected. Therefore you should cover shorts and buy without waiting for Cotton to make a higher top than a previous day or without waiting until the trend turns up by crossing a Trend Line top.

RULE #23: CLOSING NEAR THE TOP OR BOTTOM AND OPENING LOWER OR HIGHER

If Cotton has a bug advance and closes near the top or at the exact top, then the next morning opens 10 to 20 points lower, it is a sign of weakness and an indication that Cotton is going lower, especially if it fails to cross the high of the previous day.

When Cotton is declining and closes near the lowest levels of the day, then next morning opens 10 to 20 points higher and never breaks the opening price and closes near the highest level of the day, it is a sure sign of good support and indicates that Cotton is going higher. If Cotton opens higher after closing weak and holds until 11 o'clock the same day without breaking the opening, it is a sign of higher prices and you should buy.

RULE #24: A NARROW DAY AFTER A SHARP DECLINE OR A SHARP ADVANCE

After Cotton has been declining for some time and has a sharp break, closing weak or near the low level, if on the following day the range is very narrow and Cotton goes only slightly lower and closes about the same level, it is an indication that the move has run out and your stop loss order should be moved down 10 points above the top of the narrow day.

After Cotton has been advancing for some time and has a sharp advance, closing strong or near the high level, if on the following day the range is very narrow, it is an indication that a culmination is near and your stop loss order should be moved up 10 points under the bottom of the narrow day.

RULE #25:: CLOSING AT THE SAME LEVELS FOR A SERIES OF DAYS

Watch the closing price of an option after a prolonged decline or a prolonged advance. If Cotton closes for a series of days around the same level, it is an indication that it is receiving support or meeting resistance around this level. Then the first day that it closes above or below this series of closings, it will be an indication of a change in trend and you should go with it.

RULE #26: THREE TOPS OR BOTTOMS NEAR THE SAME LEVEL AND CLOSING PRICE

Watch how Cotton closes when it has a sharp run up and makes a top. If it closes below the halfway point or near the low of the day, it is an indication that it is making top. Then, when it advances to the same level the second or third time, if it reacts the same day and closes near the low, it is a sure indication of good selling and that the trend is getting ready to turn down.

Reverse this rule in a declining market. If three bottoms occur around the same level and each time Cotton closes near the high level of the day, it is an indication of higher prices and that Cotton is getting ready to turn trend up.

NOTE: All rules work best in active fast-moving markets and the big profits are made trading in active markets. If you follow these rules, you will make money. Make up your mind to follow the rules before you start and success is assured.

3-DAY CHART
OR
MAIN TREND INDICATOR

The 3-day Chart should be kept on a separate sheet of chart paper from the Daily High and Low Chart and Trend Line. It is used in connection with the Minor Trend Indicator, or the Trend Line used with the Mechanical Method, which records every move where there is a higher top or a lower bottom.

HOW TO MAKE UP 3-DAY CHART

For the 3-day Movement or Main Trend Indicator, the rules are as follows:

The 3-day Chart is made up of moves of 3 days or more. When Cotton starts to advance and makes higher bottoms and higher tops for 3 consecutive days; you move the line on the 3-day Chart up to the top of the 3rd day; then if Cotton continues to move up, making higher tops without reacting as much as 3 days, you continue to move the line on the 3-day Chart up to the top of each day until Cotton reacts 3 days or makes lower bottoms for 3 consecutive days or more.

Then you move the line on the 3-day Chart down and continuesto move it down to the lowest price as long as Cotton makes lower bottoms without rallying 3 days.

The first time that Cotton rallies 3 days from any bottom, that is, making higher tops for 3 consecutive days or more, you move the line up.

This chart is based on higher tops and lower bottoms and not on closing prices. An option may close lower on the 3rd day, but not make a lower bottom, in which case you make no change on the 3-day Chart. An option may close higher on the 3rd day from the bottom but not make a higher top on the 3rd day, and in that case, you do not move the line up on the 3-day Chart.

EXCEPTION TO RULE

There is an exception to the rule for making up the 3-day Chart. When an option is very active near the top or bottom, making a wide range, and crosses the previous Trend Line top or bottom in less time than 3 days, then you record the move on your 3-day Chart just the same as if there had been a move of 3 days in one direction.

INDICATIONS FOR CHANGE IN TREND

RULE #27: CROSSING TOPS OR BRRAKING BOTTOMS OF 3-DAY MOVES

The surest sign of a change in the main trend is when a move on the 3-day Chart is exceeded by 10 to 30 points. When an option breaks under a bottom made by the 3-day Chart, you consider that the main trend has turned down, and when a move crosses a top made by the 3-day Chart, consider that the main trend has turned up, at least temporarily.

Breaking 10 points under the last 3-day bottom or crossing the last 3-day top by 10 points in slow or semi-active markets is enough to show a change in the trend.

In active markets, allow 30 full-points under the last 3-day bottom or 30 points above the last 3-day top before considering that the trend has reversed. For final top day use your Signal-Top-Day rule and 7 to 10-day Rule to catch the extreme in wild fluctuating markets at high levels.

When Cotton breaks 10 points under a double or triple bottom made by the 3-day Chart or advances 10 points above a double or triple top made by the 3-day Chart, it is important for a change in the main trend.

RULE #28: FIRST 3-DAY REACTION OR RALLY.

After a prolonged advance, watch the first time there and 3-full days of lower prices or the first time the 3-day Chart is moved down, as this will often be the first sign that the end of the move is near.

Next, watch the second move of 3 days down on the 3-day Chart and see if it is lower than the Trend Line bottom or the minor Trend Indicator or under a 3-day bottom on the 3-day Chart. This will be a stronger indication of a reversal in trend.

Reverse rule in a declining market. After a prolonged decline, watch the first time there is a rally of 3 days, as this will often be the first sign that a change in trend is near.

RULE #29: THE THIRD MOVE ON 3-DAY CHART

The most important indication to watch is the third move down on the 3-day Chart after a prolonged advance or decline. For example: An option reacts 3 days; then advances to new high; then has a second 3-day reaction and advances to new high; then when the third reaction of 3 days comes from a new high, it is nearly always a signal that the move is over. If this third move of 3 days breaks a bottom on the 3-day Chart by 10, 20, or 30 points, depending on the price of Cotton and its activity, it is almost a sure sign that the main trend has turned down.

Reverse these rules in a declining market. Watch the first, second and third rally of 3 days. The first time a top is crossed on the 3-day Chart, consider the main trend has turned up. Also watch when the first 2-day sharp rally carries the price above the top made by the minor Trend Indicator and again apply the Closing Rule at low levels to determine the final low day for change in trend. When the move of 3 days the third time crosses a top on the 3-day Chart, it is almost a sure sign that the main trend has turned up.

HOW TO COMBINE
NEW TREND INDICATOR AND 3-DAY CHART

The Trend Line always records the minor trend of the market, and when it reverses by breaking 10 points under a previous Trend Line bottom or crossing 10 points over a Trend Line top, it shows the minor trend, but the 3-day Chart always shows the main trend of the market.

It is never safe to trade against the main trend. In other words, if the 3-day Chart shows downtrend, it is always better to sell short on rallies, using the minor trend chart for placing stop loss orders. The same when the 3-day Chart shows uptrend. It is always better to wait for reactions of 3 days and buy than it is to sell short, except in cases where there is a sharp advance.

When the Trend Line or minor Trend Indicator makes double or triple bottoms and double or triple tops and then breaks under these bottoms or crosses the tops, it will show a change in the major trend, but it is not safe to consider it a change in the main trend if the market is very low or narrow with small sales. Except on rapid advances, the 3-day moves will always show the main trend in plenty of time to get in and make money.

The big money is always made by going with the trend, and the 3-day Chart keeps you with the main trend.

RESISTANCE LEVELS

Cotton makes top or bottom on some exact mathematical point in proportion to some previous move. The movement of an option between extreme high and extreme low, either in a major or a minor move, is very important and by a proper division of this range of fluctuation, we determine the points where resistance or support will be met on a reverse move, either up or down. By carefully watching these Resistance Levels in connection with your Trend Indicators, you can make a greater success and trade with closer stop loss orders.

RANGE OF FLUCTUATIONS

1/8 POINTS: Take the extreme low and extreme high of any important move; subtract the low from the high to get the range; then divide the range of fluctuation by 8 to get the 1/8 points, which are Resistance Levels or buying and selling points. When an option stops around these levels and makes bottom or top on or near them and shows a turn on the Trend Indicator this is the place to buy or sell.

1/3 and 2/3 POINTS: After dividing an option by 8 to get the 1/8 points, it is next important to divide the range of fluctuation by 3 to get the 1/3 and 2/3 points. These 1/3 and 2/3 points are very strong, especially if they fall near other Resistance Points of previous moves or when they are divisions of a very wide move.

HIGHEST SELLING POINTS

Next in importance is the division of the highest price at which an option has ever sold and each lower top.

Divide the highest selling price by 8 to get the 1/8 points and also divide by 3 to get the 1/3 and 2/3 points.

This is very important as an option, after breaking the halfway point of the fluctuation range, will often decline to the halfway point of the highest selling price, and will also work on the other Resistance Points in the same way.

When an option is advancing, it will often cross the halfway point of the highest selling point and then advance to the halfway point of the fluctuation and meet resistance.

MOST IMPORTANT COTTON MOVEMENTS TO CONSIDER

The first and most important point: Consider the resistance Levels between the extreme high and extreme low during the past 30, 20, 10, 5, 3 and 1 years;

Next important point to consider: Resistance Points or divisions of the highest price at which an option has ever sold;

Then consider the fluctuation of each campaign which runs one year or more; Take the range between extreme high and extreme low and divide by 8 to get the Resistance Points;

Then take a second top or a lower top than the extreme high and divide it by 8 to get the important Resistance Points;

Then take a third or fourth lower top and divide it by 8 to get the Resistance Points;

When you come to the last move, which may run several weeks or several months, that is the most nmportant move to watch for your first Resistance Points.

ORDER OF RESISTANCE POINTS

When an option is advancing and crosses the 1/4 point, the next most important point to watch is the halfway point (1/2 point) or gravity center, or the average of the move or fluctuation.

Then the next point above the halfway point is the 5/8 point.

The next and strongest point after the halfway point is crossed is the 3/4 point.

Then, if the range is very wide between these points, it is important to watch the 7/8 point of the move. This will often mark the top of an advance.

But in watching these Resistance Points, always watch your Trend Line Indicators, both the Trend Line on the Daily Chart and the Trend Line on the 3-day Chart, and if they start making tops or bottoms around these Resistance Points, it is safe to sell or buy.

THE AVERAGE OR HALFWAY POINT

Always remember that the 50% reaction or halfway point of the range of fluctuation or of the extreme highest point of an option of any particular move is the most important point for support on the downside or for meeting selling and resistance on the way up. This is the balancing point because it divides the range of fluctuation into two equal parts or divides the highest selling point into two equal parts.

To get this point, add the extreme low of any move to the extreme high of that move and divide by 2.

When an option advances or declines to this halfway point, you should sell or buy with a stop loss order 10, 20, or 30 points away depending on whether Cotton is selling at very high or very low levels. It requires 30 points below a main halfway point, or 30 points above a main halfway point to show change in trend.

The wider the range and the longer the time period, the more important is this halfway point when it is reached.

When an option advances to a halfway point and reacts several points from this level, then finally goes thru it, you can expect it to make the next Resistance Point indicated on your Resistance Level Card.

The greatest indication of strength is when an option holds ten or more points above the halfway point, which shows that buying or support orders were placed above this important Resistance Level.

A sign of weakness is when an option advances and fails to reach the halfway point by 10 or more point; then declines and breaks the Trend Line or other Resistance Points.

NEXT RESISTANCE LEVELS
AFTER THE MAIN HALFWAY POINT HAS BEEN BROKEN

The next Resistance Level to watch after the main halfway point has been broken is the next halfway point of some previous move. By main halfway point I mean, the halfway point of the extreme fluctuating range of an option.

Another very important Resistance Level after the main halfway point is crossed is the halfway point or 1/2 of the highest selling price. This is a stronger support level than the halfway point of minor fluctuating moves because it cuts the highest selling price in half, and is a strong buying or selling point until it is crossed by 10, 20, or 30 points, according to the price of an option, whether it is very high, medium or low in price.

RESISTANCE POINTS NEAR SAME LEVELS

When two halfway points or any other two Resistance Points either in the range of fluctuation or the division of the highest selling price, occur near the same level, you should add these two points together and divide by 2, as the halfway point between these two points will often be a support point on a decline or a selling point on a rally.

HOW TO LOOK UP RESISTANCE LEVELS

When you find an important Resistance Level or the strongest one--the halfway point--at a certain level, look to see if any other Resistance Level, whether it be 1/8, 1/4, 3/8, 5/8, or 2/3 point, falls around the same price. You may find 3 or 4 Resistance Levels within a range around the same price. The more you find, the stronger resistance the option will meet when it reache this level. Then take the highest Resistance Level around this same price and the lowest, and add them together to get the average point of resistance.

Watch the activity of the option when it reaches these Resistance Levels. If it is advancing very fast or declining very fast on large volume, do not cc sider that it is going to stop around these Resistance Levels unless it stops holds one or two days around these levels; then sell or buy with stop loss orde

OTHER RESISTANCE POINTS

Cotton will often react 1/4 to 1/3 of the last move and continue to rall or react 1/4 to 1/3 for a ong time; then the first time it reacts more than 1/3 or breaks the 1/2 point, consider the trend has changed.

LOST MOTION

As there is lost motion in every kind of machinery, so there is lost motion in the Cotton Market due to momentum, which drives an option slightly above or below a Resistance Level. The average lost motion is about 15 points above or below important points, but 20 to 30 points means a change in trend.

When an option is very active and advances or declines fast on heavy volume, it will often go 10 or 15 points above a halfway point or other stron Resistance Level and not go 30 Points.. The same rule applies on a decline. It will often pass an important Resistance Point by 15 points but not go 30 full points beyond it.

This is the same rule that applies to a gravity center in anything. If we could bore a hole thru the earth and then drop a ball, momentum would carry it beyond the gravity center, but when it slowed down, it would finally settle on the exact center. This is the way Cotton acts around these important cente

WEEKLY HIGH AND LOW CHART

The same rules may be applied to a Weekly high and low Chart that we apply to the Trend Line Indicator and to the 3-day Chart.

As long as an option makes higher bottoms and higher tops each week on weekly chart, you move the Trend Line up to the top of the week. Then the fol lowing week, if the option does not make a lower bottom or a lower top than tl previous week, no change is made in the Trend Line, but the first week the oj tion breaks a weekly bottom by 5 points or more, you move the Trend Line dow to the low of the week and continue to move it down to the low of each week a long as the option makes lower bottoms. Then the first week that it makes a higher top than a previous week, move the Trend Line up to the top of that w and follow on, applying the same rules as applied to the other Trend Line Indicators.

For Example: If an option declines for one or two weeks, making lower bottoms, then advances, making higher tops; then reacts for one week, making a lower bottom than a previous week; then moves up to a new high and the following week, or any week after extreme high has been made, it breaks the bottom of the reaction, you consider that the trend has turned down on the Weekly Chart.

These changes in trend on the Weekly Chart are stronger than changes in trend on the 3-day Chart.

The Weekly Chart often makes double and triple bottoms and double or triple tops just the same as the Trend Line on the Daily Chart and the 4-day Chart. Therefore when the option makes a double or triple bottom on the Weekly Chart, you know that it is a strong indication for a change in the main trend to the upside. When an option makes a double or triple top on the Weekly Chart, it is a sign that it is meeting resistance and making final top.

The Rule of 3 may be applied to the Weekly Chart. An option will often react 3 weeks and not go lower the 4th week. If it does go slightly lower in the early part of the 4th week and at the end of the 4th week closes strong at or near the top of the week, it is an indication that the main trend has not changed and that the option is going higher. But any time an option does break under a bottom after having reacted 3 weeks and then rallies, it is in a very weak position and indicates much lower prices, especially if the option is at very high levels.

Reverse all of these rules in a declining market. If an option rallies 3 weeks from any bottom, then goes lower to a new low and later crosses the top that it made before the 3 weeks' rally, it is a very important change in trend, which may last for some time.

7 to 10 WEEKS' MOVES

After accumulation and distribution has been completed, Cotton will often advance or decline rapidly with only 2 to 3 days' reverse moves, running up or down 7 to 10 weeks. On these moves you can pyramid and make big profits.

Watch for culmination around the 49th to 52nd day after a move starts, and if bottom or top is not made around this time, then watch for the next move around the 66th to 70th day.

By going back over the charts and checking the moves, you will see how important this rule is.

Many of my successful students use the 3-day Chart and the Weekly Chart for long pull trading and have made some very successful pyramids with these two charts alone.

HOW TO DETERMINE CULMINATIONS AND CHANGES IN TREND

The big money is made in the Cotton Market by following the main trend or big swings and not changing position or taking profits until the market shows by its own action that the trend has changed. If you will follow the rules, the market will tell you when the main or minor trend changes. Do not guess or trade on hope or fear. Give the market time to show a change in trend.

The activity and range in prices at high or low levels determine the change in trend according to whether the market is normal or abnormal. Abnormal prices and fluctuations occur during wars or after wars. The years when crops are very large or very small cause abnormal moves which run to extremes. You must never try to guess when tops or bottoms will be reached in abnormal markets as they will nearly always run longer than human reason or known facts would lend you to believe. That is why you must apply rules and wait for the market's action to show a definite change in trend.

FOUR RULES

Rule 1 - TIME RULE

The TIME FACTOR is the most important. When TIME is up, Time or Space movements will reverse.

Keep a record of the days that the market reacts, that is, actual trading days; also keep a record of the calendar days of each reaction or rally. When a reversal comes that exceeds the previous TIME movement, consider that the trend has changed, at least temporarily. After any important top or bottom is reached and the first reaction or rally comes, there is nearly always a secondary move which usually makes a slightly higher bottom or a lower top. The duration of this move may be 1, 2, 3 days or more, all depending upon the activity of the market and the duration of the advance or the decline. But your rule is to watch for an overbalancing of a previous TIME period before deciding that the trend has changed.

Rule 2 - SWING BOTTOMS AND TOPS

When a market advances, it continues to make higher bottoms and higher tops on the main swings. You must watch all of these reactions or bottoms; then the first time a SWING BOTTOM is broken, whether it be for 1, 2, 3 days or more, consider that the trend has changed and go with it.

When a market is declining, it continues to make lower bottoms and lower tops on the main swings. Therefore, when the last SWING TOP is crossed, it indicates a change in trend.

Rule 3 - SPACE OR PRICE MOVEMENTS

By SPACE MOVEMENTS, I mean points up or down from top to bottom. For example: Suppose Cotton starts to advance from 20¢ per pound and advances to 25¢ per pound and makes top; then reacts to 24 cents, advances to 26¢ and reacts to 25¢, a reaction of 100 points; later it again advances (as it did in 1946 to 3685 for March Cotton) and reverses, breaking back more than 100 points or a greater movement than a previous space reversal, this would indicate that the main trend had turned because the SPACE MOVEMENT had "*overbalanced*" the previous moves indicating a change in trend. But you must never depend upon the SPACE MOVEMENT alone to give a definite indication of a change in trend until it is confirmed by the reversal in TIME PERIOD and by the market breaking the last SWING BOTTOM.

Rule 4 - RESISTANCE LEVELS

When the price breaks back one-half or more of the previous SWING, this is also an indication of a change in trend. In a declining market, a rally of one-half or 50% or more of a SWING is the first indication of a change in trend. But these indications must be confirmed by the TIME RULE before you can be sure that there is a definite change in trend.

A review and study of past market movements will prove to you the accuracy and value of these rules.

Study the movement of October, March, and July Cotton from August 1945 to October 8, 1946.

AVERAGE SPACE MOVEMENT

As a general rule, Cotton will react in normal markets more than 100 points before the main trend is resumed, but when it is selling above 30¢ per pound reverses can run anywhere from 175 to 400 points or whatever SPACE MOVEMENT the market has previously made. When this is reversed and exceeded, it will show a change in trend, especially when confirmed by the Time Rule.

WHEN COTTON IS IN THE STRONGEST OR WEAKEST POSITION

When Cotton is advancing and is in the last stages of a fast up-swing, reactions will often last only 2 days and then the advance will be resumed. An advance of this kind will sometimes run 42 to 49 days or 6 to 7 weeks and in extreme cases may run 3 to 4 months, but around 84 to 90 calendar days it is very important to watch for a change in trend.

Example — OCTOBER COTTON - 1946 Delivery

1945

May 31 Opened at 2150

Jun 11 High 2220

18 Low 2150, buying level -- same bottom as May 31.

Jul 10 High 2237, selling level. Did not go 30 points above top of June 11.

16 Low 2195

18 High 2220, lower top. When it broke the last SWING BOTTOM at 2195 it showed downtrend and never had more than a 2-day rally.

Aug 20 Low 2063, down 174 points in 41 days from July 10 top. (Note low of previous option was 2034 on Dec. 14 and 29, 1944, making 2063 a higher SWING BOTTOM.)

22 High 2105, a 2-day rally.

24 Low 2077, a 2-day reaction. Then moved up more than 3 days and crossed SWING TOP at 2105, showing main trend up and time to buy.

Sep 13 High 2182.

Sep 15 Low 2150, a 2-day reaction.
19 High 2185.
26 Low 2156, above low of Sept. 15, the last SWING BOTTOM -- a buying level with stop at 2130. Main trend continued up and prices crossed 2237, the high of July 10, in the month of October, showing uptrend. You should buy more.
Nov 13 High 2371.
17 Low 2275, down 96 points in 4 market days. Last SWING BOTTOM was 2243, made in October. Failing to break it showed main trend up. It started making higher bottoms.
Dec 27 High 2388.

1946
Jan 7 Low 2328, down 60 points in 7 market days.
Main trend continued up and prices crossed previous tops with no 3-day reaction.
Feb 16 High 2637.
20 Low 2569, down 68 points in 3 days.
Mar 4 High 2716.
6 Low 2628, down 88 points in 2 days.
Note Nov. 16 to 20 it declined 96 points but this time did not decline as much. Trend still up.
11 High 2687, up 4 days.
16 Low 2640, down 5 days, a higher SWING BOTTOM than Mar. 6. Trend still up. Prices moved up and crossed Mar. 4 high.
25 High 2722, a new high.
26 Low 2688, only one day reaction. Main trend up.
Apr 6 High 2845. From Mar. 26 this was 10 market days with no day's low below the previous day's lowest.
9 Low 2782, down 63 points in 2 days. This was not as much as the reaction from Mar, 4 to 6, when it declined 88 points in 2 days.
10 High 2834, up 52 points in 1 day. Main trend still up. Last SWING BOTTOM made April 9 at 2782. When this bottom was broken, it indicated lower prices because no SWING BOTTOM had been broken since Aug. 20, 1945.
12 Low 2706. This low level was not broken and the market moved in a narrow trading range making higher support levels until June 3 when the market advanced to new high levels, crossing the highs of April 6, which was a signal for very much higher prices.
Jul 19 High 3665. There were never more than 2-day reactions, and no reaction of more than 120 points from the low of April 12. The market made a Signal Day which indicated top for a greater reaction. On the 3rd day from the top the market had declined over 200 points which exceeded all reactions from August 20, 1945 to date.
Jul 30 Low 3145, a decline of 500 points in 8 market days. This was the greatest decline since the lows were reached Dec. 10, 1938. The decline from the high of 1937 was 670 points. This sharp decline from July 19 to 30 indicated a reversal in trend and that the Bull Market was nearing its final top.
Aug 8 High 3652, a sharp advance from the low of July 30.
Aug 20 Low 3525. Prices down a little over 100 points from the high of Aug. 8. After this decline there was no reaction that lasted more than 2 days and no decline of more than 160 points until October 8.
Oct 8 High 3928, the highest in the history of this option. The previous high on October Cotton was 37.25 in April, 1920.
From the high of October 8 the market broke back 3 days, then rallied

making a lower top, then declined and broke the TREND LINE BOTTOM giving a definite indication that the main trend had turned down. This decline exceeded 500 points, which was the decline from July 19 to 30, and also indicated, according to SPACE MOVEMENT, that the main trend had turned down. The most important indication of a change in the major trend was when the market declined more than 7 market days from the high of October 8 exceeding the TIME PERIOD from July 19 to July 30, and indicated by TIME amd PRICE or SPACE MOVEMENT that the main trend had turned down. From that time on Cotton was a sale on all rallies, as indicated by the Trend Line indications and other rules.

Remember that the "*overbalancing*" of TIME is the most important indication of a change in trend.

Study the March, July and October options in future years and apply these rules and you will see how well they work out.

This Mechanical Method is based on fixed rules which will overcome the human element, eliminating hope and fear as well as guesswork. Learn to stick to the rules, trade in active markets and your success is sure.

W. D. Gann

June 2, 1948